

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 95-0529 ST
Sales and Use Tax
For The Tax Periods: 1992 through 1994

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ISSUES

I. **Sales/Use Tax – Utility Exemption:** Natural Gas Purchases

Authority: 45 IAC 2.2-4-13

Taxpayer protests the assessment of unpaid use tax on purchases of natural gas in 1992.

II. **Sales/Use Tax – Utility Exemption:** Electricity Purchases

Authority: 45 IAC 2.2-4-13, Indianapolis Fruit Co. v. Department of State Revenue No. 49T10-9702-SC-00129 Indiana Tax Court (Feb. 25, 1998)

Taxpayer protests the assessment of unpaid use tax on purchases of electricity from the assessment period 1992 through 1994.

STATEMENT OF FACTS

Taxpayer is engaged in the business of operating a fast food franchise. Taxpayer sells food for immediate consumption. Taxpayer specializes in the sale of fried chicken in addition to selling other types of chicken and side-dishes.

I. **Sales/Use Tax – Utility Exemption:** Natural Gas Purchases

DISCUSSION

Pursuant to IC 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana. IC 6-2.5-4-1 provides that a retail transaction involves the transfer of tangible personal property. Pursuant to IC 6-2.5-3-2, “an excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.”

45 IAC 2.2-4-13(c) states that sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5 (based on a single meter charge, flat rate charge, or other charge) are excepted if such services are separately metered or billed and will be used predominantly for excepted purposes.

Pursuant to 45 IAC 2.2-4-13(e), where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50%) of the utility services and commodities are consumed for excepted uses.

Using the months June, July and August, the auditor determined that for the year 1992, taxpayer’s percentage of gas used for cooking food was 48.92%. This amount of usage precluded taxpayer from the predominant use exemption provided by 45 IAC 2.2-4-13. Taxpayer was assessed use tax on the remaining 51.08% of natural gas used. Incidentally, using the same three months for calculations in 1993 and 1994, taxpayer received the predominant use exemption for these years.

Taxpayer argues that a more reasonable percentage could be determined by using the months April through September to determine the amount of gas used in cooking food in 1992. Using these months, the amount of gas used for cooking food would be, according to taxpayer’s calculations, 52.24%; thus, qualifying them for the predominant use exemption.

The taxpayer does not contest the auditor’s use of months June through August in tax years 1993 and 1994. The Department finds that the auditor consistently applied a formula to determine natural gas usage for each year audited. Changing the method of calculation for the only year in which taxpayer failed to qualify for the predominant use exemption is not reasonable; such a diversion would be inconsistent and would not fairly represent taxpayer’s usage of natural gas for the entire audit period.

FINDING

Taxpayer's protest is denied.

II. Sales/Use Tax – Utility Exemption: Electricity Purchases

DISCUSSION

Taxpayer contends that their purchases of electricity during the assessment period are also exempt pursuant to 45 IAC 2.2-4-13. 45 IAC 2.2-4-13(e) states that where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50%) of the utility services and commodities are consumed for excepted uses.

Pursuant to the auditor's electricity usage study, the taxpayer does not qualify for the predominant use exemption. The auditor determined that taxpayer's exempt electricity usage amounted to 45.93%. Taxpayer arrived at an amount of 54.59% by altering two factors. First, taxpayer contends that one of its three Collectramatic fryers was used 363 days per year and not 46 days as determined by audit. Secondly, taxpayer asserts that the auditor failed to include the electricity used to operate two holding cabinets that taxpayer believes are part of its production process.

The auditor determined that the third fryer was placed in storage most of the year and that it was only used in peak times. This finding was made pursuant to discussions with the taxpayer's President. Taxpayer contends that the third fryer was used year-round and was necessary to meet the restaurant's daily demands. As evidence, taxpayer suggests that it is reasonable to infer year-round usage by the fact that prior to the audit, taxpayer used a 20-head Automatic Cooker that was replaced by the three 6-head Collectramatic Fryers. The amount of days the fryer was used is not dispositive in this protest. Even if the electricity study included the third fryer as being used 363 days per year, taxpayer's exempt electricity usage would still not be over 50%. The electricity used to operate the holding cabinets would need to be included in order for taxpayer to qualify for the predominant use exemption; this usage of electricity is not exempt.

Taxpayer's holding cabinets are heated and include racks on which the chicken is placed to drain excess shortening. Taxpayer contends that these holding cabinets are an essential and integral part for the production of taxpayer's specialized production of chicken. Taxpayer argues that the fried chicken is not completely altered into a form suitable for sale until it has been processed in these cabinets for at least 5 minutes. Taxpayer's franchise literature includes this step as an essential part of production in the recipe for taxpayer's chicken.

The Indiana Tax Court determined in Indianapolis Fruit Co. v. Department of State Revenue No. 49T10-9702-SC-00129 Indiana Tax Court (Feb. 25, 1998) that equipment

used to create a more marketable product is not sufficient to be considered a manufacturing exemption. The court held:

This Court finds that the tomato ripening does not constitute production within the meaning of any of the exemption provisions. It is indisputable that, like the bananas, the tomatoes have undergone a substantial physical and chemical change while ripening. Although this transformation undoubtedly made the tomatoes far more marketable, the transformation was not triggered by Indianapolis Fruit. Instead, it passively awaited the ripening of the tomatoes. The ripening was not actively induced by Indianapolis Fruit and was merely incidental to the proper storage of the tomatoes.

In this case, although draining the excess shortening from the chicken may in fact make the taxpayer's product more marketable, the taxpayer passively awaits the draining of the chicken. The taxpayer does nothing to induce the change in the chicken and the change is incidental to the proper storage of the chicken on the racks of the holding cabinet. Therefore, taxpayer's electricity usage to operate its holding cabinets is taxable and was properly excluded from the auditor's electricity study.

FINDING

Taxpayer's protest is denied.